

European Securities and Markets Authority

103 rue de Grenelle

75007 Paris

FRANCE

E-mail to: info@esma.europa.eu

19 March 2012

RE: Contribution to the consultation on Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

The European Federation of Energy Traders (EFET) ¹ appreciates the opportunity to respond to the consultation by European Securities and Markets Authority (ESMA) on its Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories. We have limited ourselves to commenting on those questions most relevant to the interests of EFET members.

EFET key concerns are summarised below followed by detailed explanation and answers to specific questions set out in the Annex:

- It is of crucial importance to identify accurately which type of contracts will be considered in the scope of the regulation. This is essential to assess the overall impact of EMIR and the proposed Regulatory Standards. In particular, we believe that physically settled forward products that do not meet the characteristics of other derivative financial instruments defined in MiFID Implementing Regulation 1287/2006 shall not be considered in the scope. We urge ESMA to accommodate the views solicited with regard to this Discussion Paper in accordance with the mandate foreseen in Article 1b of EMIR and not to await the publication of definition of draft technical standards for consultation during next summer;
- EFET welcomes the proposed definition of OTC derivatives that are 'objectively measurable as reducing risks' as a useful starting point, but considers that some further improvements are required to fully reflect EMIR objectives. Furthermore, companies should have a flexibility to implement the proposed definition within their internal systems and processes;

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

- We are concerned with ESMA proposal to define the clearing threshold at a low level. As explicitly stated in Article 5, 4 (b) of EMIR, the value of the clearing threshold should be set at a systemic level. If the threshold is not set at a systemic level, this will unintentionally mandate more firms into central clearing with a significant impact on their costs and a reduction in market liquidity;
- It is crucial that bank guarantees can be used as collateral at exchanges and clearing platforms as is common practice in energy markets without undue restrictions, including the denomination of the collateral;
- Any minimum level of cash collateral must balance the issue of cash liquidity and creation of barriers to entry or undue restrictions on firms' activities. It is crucial that firms retain title to any cash not directly related to their obligations and that strict segregation rules apply within the CCP;
- Transaction reporting has the potential to become very complex and burdensome for non-financial companies. Alignment between trade data reporting obligations under especially EMIR and REMIT, but also Dodd-Frank Act and MiFID is of high importance. Given the subject complexity, ESMA must allow an appropriate implementation period for non-financial companies. The content and format of reporting, as well as the reporting framework development and implementation timeframe must be coordinated with other relevant competent authorities. In particular, EFET calls upon ESMA to work closely with ACER, including organisation of joint workshops on the development of the detailed requirements.

If you have any questions regarding this response, please do not hesitate to contact: Karl-Peter Horstmann (Chair of EFET Task Force Market Supervision), Cemil Altin (Vice-Chair of EFET Task Force Market Supervision), Reinier Waters (Chair of EFET Working Group on EMIR) and Peter Styles (Member of the EFET Board, Chairman of the EFET Electricity Committee).²

Yours sincerely,

On behalf of the European Federation of Energy Traders (EFET)



Jan van Aken

EFET Secretary General

² karl-peter.horstmann@rwe.com or telephone: +49 201 12 17780
reinier.waters@nuon.com or telephone: + 31 6 55 69 78 13
cemil.altin@edftrading.com or telephone: +44 (0) 20 7061 4386
peter.styles@efet.org or telephone: +44 7793 746939

Section 1: Requirements for (non) cleared OTC derivatives (Q1 - Q22)

Contracts having a direct, substantial and foreseeable effect within the EU (1)

Q1: In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?

Only OTC derivative contracts that are traded in large volumes by financial institutions should be considered to have a direct substantial and foreseeable effect, as other contracts have no substantial and foreseeable effect within the EU and, therefore, have no impact on systemic risk. ESMA should specify these contracts in order to ensure legal certainty when establishing the clearing obligation.

Contracts having a direct, substantial and foreseeable effect within the EU (2)

Q3: In your views, what should be the characteristics of these indirect contractual arrangements?

A client of a General Clearing Member should be sufficient to be considered an 'indirect contractual arrangement' and, therefore, to assess compliance with the clearing obligation. Additionally, arrangements agreed between counterparties to use clearing services, offered by central counterparties after the conclusion of an OTC transaction, should be considered contractual arrangements sufficient to meet the clearing obligation.

Criteria to be assessed by ESMA under the clearing obligation procedure

Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, and availability of pricing information?

EFET generally agrees with the approach outlined in the Discussion Paper. However, with regard to the 'availability of price information' it is necessary to also refer to the availability of *pricing models* and to the extent that standard models (or market best practice approaches) are available. A further issue is that prices not only need to be easily accessible, but also to be proven "traded"/ "executable".

Criteria for establishing which derivative contracts are objectively measurable as reducing risk directly related to the commercial activity or treasury financing

Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?

The definition proposed by ESMA is a useful starting point. Member companies of EFET specifically rely on (financial) derivative contracts to reduce the risks that stem from potential changes in the value of their assets, services inputs, products or commodity liabilities. These financial risk management activities are undertaken as ancillary to the core physical

business, but are vital to ensure that the commercial business can be undertaken in a responsible and properly controlled manner.

EFET main comments on the definition are:

- market participants should have flexibility to determine how they distinguish between OTC derivatives which aim to reduce risks and those which do not. This means that the ESMA definition of an OTC derivative which aims to reduce risks should *not* be limited to the IFRS hedge accounting principles as referred to in IAS 39 paragraph 71-102 (cf. § 30. of the ESMA discussion paper);
- it is more appropriate to maintain a broad, single definition of OTC derivative contracts that are objectively measurable as reducing risks directly related to the commercial or treasury financing activity category in EMIR, which would be easier to implement compared to different specific hedging categories such as those that exist under the Dodd-Frank Act. Firms undertaking hedging at a portfolio level should be accommodated by the definition of OTC derivative contracts and foresee the flexibility firms need for implementation. EFET therefore strongly agrees with ESMA that firms should retain flexibility in how they implement the definition within their internal systems and processes;
- it is important that ESMA confirms that the proposed definition also covers anticipatory hedging of *future* risk and commercial activities;
- changes in the cash flow from commercial activity (e.g. in the energy industry the level of revenues depend ultimately on the fluctuating consumption of end consumers) need to be hedged, and it is proposed this is clarified in the definition;
- the risk of fluctuation in commodity prices is a further risk that non-financial have to mitigate (and which is explicitly mentioned in the EMIR Recital 16a). Therefore, a reference to commodity prices needs to be inserted into the definition;
- the proposed definition should be consistent with other financial regulation developed at EU level, such as the MiFID II reform. It should clarify that transactions for the forward sale of output and/or the forward purchase of inputs by a non-financial firm which are contractually bound to be physically delivered are not to be considered as (OTC) derivatives subject to EMIR;
- it should also be made clear that although ISA 39 is provided as an option for firms to classify their hedging activity, an accounting approach should not be seen as the only method for implementing the definition;
- finally, the wording of § 31 “... *OTC derivative which is used for a purpose in the nature of speculation, investing, or trading should not be [exempted]...*” remains unclear. The concepts of *speculation*, *investing*, and *trading* are not defined in the original text of EMIR and, therefore, we feel that this reference in the technical standards may ingenerate confusion. It could be counterproductive with regard to the pragmatic approach suggested by ESMA for the definition of risk-reducing OTC derivatives.

Clearing Threshold

Q11: In your views, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?

Systemic relevant clearing threshold

Although EFET agrees with the proposed definition of transactions that reduce commercial or treasury financing risk, it is not appropriate to set the clearing threshold at a “low” level given the significant consequences associated with capturing firms that do not pose a systemic risk to the financial system. Furthermore, EFET would like to point out that a “broad” definition of risk-reducing transactions may not necessarily offer the right counterbalance to “low” thresholds, since EMIR’s clearing and collateralisation obligations apply to all (future) transactions once a non-financial crosses the threshold.

If the threshold is not set at a systemic level this might decrease market liquidity as players that become subject to mandatory clearing may be forced out of the market or reduce their activity because of the additional costs and cash liquidity risks (arising from initial and variation margin requirements) of doing business. It would also perversely increase the overall level of risk in the relevant sector as firms could increasingly decide to run unhedged positions for their commercial risk. The only way to avoid this outcome is to set the clearing threshold at a systemic level. It is also explicitly stated in Article 5, 4 (b) of EMIR that “the value of the clearing threshold shall be determined taking into account the *systemic relevance* of the sum of net positions”.

The requirement to post margin, but particularly initial margin – whether for cleared (where initial margin is posted but not received) or uncleared (where any receipts have to be segregated) transactions – will in effect require non-financials to divert capital away from otherwise productive economic activity. We believe that the intention behind EMIR’s Article 5(4)b is to circumscribe any undesired impact on the real economy by limiting the requirement for risk mitigation through collateralisation to circumstances where there is a genuine and warranted need for it; i.e. when the non-financial poses systemic risks to the financial system.

EMIR Recital 16 stipulates that the Commission should conduct an assessment of the systemic impact of transactions by non-financials by 31 December 2015. We ask for ESMA consideration, in the first place, of whether it is appropriate that calibration of thresholds should be deferred until the Commission’s assessment is completed. Further, it is anticipated that the MiFID review, through the proposed amendments to Art 2.1(i) and (k), will bring into MiFID scope any non-financials whose dealing on own account in commodities derivatives is not ancillary. Such firms will eventually become subject to EMIR as financial counterparties. We feel that the setting of “low” thresholds under EMIR will in effect pre-empt, possibly inappropriately, the outcome of the MiFID review.

Metric to be used for setting the clearing threshold

A decision needs to be taken about the appropriate metric to use for setting the clearing threshold. There are two broad options: a market or credit approach.

If a market based approach to the clearing threshold is taken, the two main options are available: the notional value of OTC derivatives or measure of the mark to market value of OTC derivatives. The notional value is easy to implement and would help to avoid valuation

discussions, however, it is not a useful measure of risks. If for the benefit of simplicity the former is to be adopted as the metric for the clearing threshold, then this will need to be reflected in the level of the threshold (as the notional value of some standardised commodity derivative contracts can be very large due to the nature of the contract/underlying physical commodity).

For example: a long term contract (10 years) with high volumes, but a month-ahead price indexation might have a huge nominal value but the potential market risk and market disruption is limited. This seems inconsistent with ESMA view to set the clearing threshold at a very low level. As such there is a significant risk that non-financial firms trading some commodity derivatives could inadvertently find themselves above the clearing threshold. Furthermore, we believe that ESMA should provide arrangements to enable the consideration of net positions for setting the threshold as stipulated by EMIR.

If ESMA were to introduce the clearing threshold on the basis of notional values, EFET is of the opinion that such a clearing threshold should be set as a relative figure, i.e. it should represent a relative share of the notional value of a firm's OTC derivatives positions to the overall market in the relevant OTC derivative class.

An alternative approach could be the calculation of the clearing threshold on the basis of the credit risk exposures caused by the non-financial firm's net OTC derivatives positions. The unsecured credit risk exposure of non-financial firms to systemically relevant financial institutions is the basis for the assessment whether a non-financial firm is of systemic importance. If a credit approach to the clearing threshold is taken, it should be remembered that one of the key objectives of EMIR is to reduce the overall level of credit risk in OTC derivative markets as this is the main route for creating and channelling systemic risk in financial markets. Nevertheless, we acknowledge that such an approach may require additional complexity.

In any case, non-financial firms should be allowed to take the effects of bilateral netting and margining agreements into account when they calculate their positions and exposures. The netting of risks is an appropriate way to reduce risks and makes margining dispensable. The market implications are also always on the net amount to other counterparties.

Given the above considerations ESMA should give further thought to the most appropriate metric for setting the clearing threshold.

Setting the clearing threshold across asset classes vs. per asset class

We agree that the clearing threshold should be simple to implement for non-financial firms and as such it is more appropriate to set it across all asset classes rather than for individual asset classes. This would also allow firms to take account of cross commodity hedges on a portfolio level and would be more consistent with the requirement to set the clearing threshold at a systemic level.

An overall approach across all asset classes will define only one number for the systemic relevance of a company. Due to the scope of the threshold the amount should be significantly higher than looking at individual markets. However, if the threshold is breached all eligible derivative contracts would have to be cleared. This is especially critical if the clearing obligation refers to the whole group and obliges all group entities to clear new contracts.

If ESMA considers thresholds per asset class, these should not be defined too narrowly. Too narrow classes would increase the risk of breaching one of the thresholds with all of its consequences of requiring all OTC derivatives to be cleared.

Group level (consolidated) vs. legal entity level

There is a need to consider carefully whether the clearing threshold is operated at a group level or entity level. We agree that firms should not be able to circumnavigate an entity level threshold by creating new entities in order to ‘utilise’ the threshold several times. At the same time, it should be made clear that a breach of any clearing threshold at the group level should not result in all legal entities within the Group having to clear their OTC derivative transactions. This may mean, as ESMA suggests, the creation of a dual clearing threshold (assessed at both group and one at entity level) with the clearing obligation only triggered if both are breached. It should be made clear that a breach of any clearing threshold at the Group level should not result in all legal entities within the group having to clear their OTC derivative transactions.

We note that dual thresholds and the time limits for how long the thresholds can be breached would need to be considered in light of the additional time required for firms to aggregate and monitor positions at a group level. If dual thresholds are set, it may be appropriate that the 30 day time limit for how long firms can breach the threshold applies to the entity level threshold only. Different arrangements may be more suitable for a threshold set at a group level, given that a Group wide assessment will inevitably be more backward looking.

However, the group threshold should not be calculated in a simplistic way, for example assuming some multiple of the entity level threshold. Any group level threshold should therefore refer to the remaining business activities within the Group in that asset class or across all asset classes depending on the approach taken.

Timely Confirmation (1)

Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be more confirmed more quickly than one that is not?

It is generally true that in most cases a trade that is electronically executed and/or electronically confirmed is capable of being confirmed more quickly than one that is not. This is mainly because these trades are part of a standardised process and in a standardised format, enabling a faster implementation of additional processes like reporting. Such a process approach supports also strongest requirements on the timeliness and data integrity and security. However, we do not support the proposal that non-financial firms above the clearing threshold should confirm derivative transactions within 15 minutes as this would be difficult to implement in practice and lead to significant additional costs without any material benefits in terms of mitigation of operational risk.

A number of additional points also need to be taken into account:

- the distinct nature of two parties to a given transaction will mean that the confirmation requirement will be different depending on whether a non-financial counterpart is above or below the clearing threshold. It is unclear whether the 15 minute confirmation requirement would apply in such cases;

- EMIR envisages non-financial firms being moving around the clearing threshold potentially triggering and de-triggering the clearing obligation. However, putting in place systems and processes for delivering confirmations within 15 minutes cannot be similarly switched on or off. As such, it is not clear how ESMA proposal will work for non-financial firms;
- industry infrastructure around electronic execution and confirmation is still evolving and as such it would be a significant step to move towards a 15 minute requirement, which cannot be justified on a cost or mitigation of risk basis;

Timely Confirmation (2)

Q13: What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?

The status of the confirmation process of every transaction is included in the details required in transaction reporting under the current proposal in the Discussion Paper. If unconfirmed transactions need to be reported separately then this should not require any additional information relating to confirmation content or specific transaction data. In addition, it is appropriate to have a different limit for non-financial firms as opposed to the current industry standards for financial firms (of 30 days). As such, we suggest a quarterly reporting obligation for non-financial firms for unconfirmed OTC derivative trades.

Marking-to-model

Q14: In your views, is the definition of market conditions preventing marking-to-market complete? How should European accounting rules be used for this purpose?

Q15: Do you think additional criteria for marking-to-model should be added?

The proposed standards for using marking-to-model are pragmatic and workable. We believe that specific consideration should be given to the extent to which models based on market best practice are applied; the availability of public information about the applied models (e.g. scientific papers); the easy availability in the market of the input parameters for the models or whether they need to be derived from others.

We would suggest, however, that paragraph 45e should be amended to require the marking-to-model models to be approved by the board *or delegated committee*. As derivative valuation models are generally highly technical and specialised the board of a company is probably not the most suitable body to approve them. Normally this approval is delegated by the board to the Risk Management Committee or equivalent of a company.

Reconciliation of non-cleared OTC derivative contracts

Q16: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?

We do not understand the rationale of ESMA to require reconciliation of non-cleared OTC derivatives contracts. If ESMA decides to go down this route we regard a minimum number of transactions as necessary. Otherwise, commodity companies would be obliged to remind all of their industrial clients about the conditions of the underlying supply contract on a frequent basis. We would propose a combined threshold of a certain number (5) and a certain notional value (kWh) between the counterparties as a minimum requirement to avoid a lot of useless effort.

Portfolio Compression

Q17: What are your views regarding the threshold to mandate portfolio compression and the frequency for performing portfolio compression?

Paragraph 52 uses the broad range of “non-centrally cleared derivative transactions” for defining the obligation to use portfolio compression. This would mean storage and gas and power network transportation agreements and supply contracts to clients being covered. In principle each municipal entity has to “provide a reasonable and valid explanation to the relevant competent authority for not conducting such an exercise.” This makes no sense and is contrary to the “cost and benefit” approach, outlined in Note 4 of ESMA.

In addition, the definition refers to “their full portfolio”. Companies may, however, want to exempt certain trades from the portfolio compression exercise, such as trades which form part of a hedge relationship for IFRS accounting purposes. These trades are specifically linked to a hedged item, and cannot be closed out early because they are part of an accounting relation. If these trades would not be exempted from portfolio compression and are closed out early then it would not be possible to perform the hedge effectiveness test.

Dispute resolution

Q18: What are your views regarding the procedure counterparties shall have in place for resolving disputes?

Q19: Do you consider that legal settlement, third party arbitration and/or a market polling mechanism are sufficient to manage disputes?

Q20: What are your views regarding the thresholds to report a dispute to the competent authority?

Market participants in the energy sector generally rely on master netting agreements that also have dispute resolution clauses in place. The proposals from ESMA would duplicate and potentially conflict with existing market practice for conflict resolution. Associations such as EFET and ISDA have been actively developing market standards and their documentation is widely used in the industry. We, therefore, feel that ESMA should align their proposals with existing standards from EFET and especially ISDA.

Intragroup exemptions

Q21: In your views, what are the details of the intragroup transactions that should be included in the notifications to the competent authority?

Q22: In your views what details of the intragroup transactions should be included in the information to be publicly disclosed by counterparty of exempted intragroup transactions?

The purpose of this notification is to allow competent authorities to assess whether transactions between Group entities can be classified as intragroup transactions for the purpose of EMIR (and in particular with a and b of the relevant subparagraphs). It is important that competent authorities can achieve this objective without creating an overly burdensome reporting requirement on firms (i.e. there should not be a requirement for notifying or reporting individual transactions). As such, firms should include in the notification:

- the company name;
- the name of the Group counterparty they wish to deal with;
- a generic description of the kind of derivative transactions for which they wish to take advantage of the exemption;
- a general description of their risk management procedures applying to such transactions; and
- a statement that the criteria developed by the EU regulatory authority for there not to be impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties has been met.

Firms should be able to make advance notifications in anticipation of any intragroup derivative transactions. The notification should only need to be made to one of the 'home' competent authorities in cases where the Group counterparty is registered in another EU Member State or third country. Once the notification has been submitted, firms should not be required to submit any additional information in relation to the exemption unless the underlying basis on which the notification is made changes materially.

The notification to the market should only be for the purpose of highlighting that the exemption has been utilised. As such, there is no need for detailed information to be published and the notification should be limited to the name of the counterparties to which the intragroup exemption refers.

Access to a venue of execution

Q23: What are your views on the notion of liquidity fragmentation?

It is important that clearing members have the ability to transfer positions from one CCP to another as easily and as seamlessly as possible in order to avoid potential severe market dislocations in the event of a CCP entering into financial difficulties and to allow appropriate and efficient clearing diversification by market participants. Currently some commodity exchanges do not permit market participants using more than one CCP (or make it very difficult to change CCP). Preventing restrictions on use of CCPs and making the process of change easier will help to alleviate potential systemic risk associated with CCP failure.

Organisational requirements (1)

Q24: What are your views on the possible requirements that CCP governance arrangements should specify? In particular, what is your view on the need to clearly name a chief risk officer, a chief technology officer and a chief compliance officer?

The effective governance of CCPs will be crucial given their potential systemic importance, and consistent governance arrangements must be put in place that are clear and understandable for all market participants. We agree with the need to appoint and clearly identify chief risk officers, a chief technology officer and a chief compliance officer. However, this should not be seen as substitute for full disclosure by the CCP of their relevant risk policies, IT and operational policies and compliance arrangements. Full disclosure allows market participants to make their own assessments of the robustness of the arrangements that have been put in place by CCPs.

Organisational requirements (2)

Q29: Should a principle of full disclosure to the public of all information necessary to be able to understand whether and how the CCP meets its legal obligations be included in the RTS? If yes, which should the exceptions of such requirements? Has the information CCPs should disclose to clearing members been appropriately identified? Should clients, when known by the CCP, receive the same level of information?

Yes, full disclosure is necessary to help establish confidence in CCP arrangements. Information to be disclosed should include:

- CCP financial resource requirements;
- results of CCP back testing of its initial margin calculation and regular disclosure of its back testing methodology, stress tests and results;
- CCP exposures and balance sheets;
- credit check methodology CCPs carry out on behalf of its prospective clients and their ability to post collateral;
- transparency and clarification on how margins are being calculated;
- evidence of the back-up funding lines of either CCP or Clearing broker and visibility of the effectiveness of their controls; and
- the netting arrangements across different products in order to ensure they are efficient.

Business continuity

Q32: What are your views on the possible requirements for the business continuity and disaster recovery plan and in particular on the requirements for the secondary site? Would it be appropriate to mandate the establishment of a third processing site, at least when the conditions described above apply? What are the potential costs and time necessary for the establishment of a third processing site and for immediate access to a secondary business site?

There is clearly a balance to be struck between ensuring CCP arrangements are robust and the costs that will be incurred by clearing members for using their services. A requirement for the establishment of a third processing site could unduly increase the costs for clearing members with little additional benefit in terms of mitigation of operational risk.

We would rather urge a requirement for a high degree of interoperability between CCPs so that non-defaulting portfolios can be ported relatively seamlessly to another CCP rather than having to unwind large portfolios over the course of a relatively short period of time which could lead to further market dislocation.

Section 2: CCP requirements (Q23 – Q68)

Collateral Requirements (1)

Q44: Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?

The criteria to define commercial bank guarantees (CBG) as highly liquid collateral proposed by ESMA are too restrictive. ESMA should acknowledge the different nature of financial counterparties compared with financials, in particular in regard to access to cash collateral. Bank guarantees are a very important tool for non-financial companies to manage daily liquidity requirements. They allow firms to manage working capital in a more efficient manner and avoid that cash is tied up at exchanges for margining requirements. In the Nordics for example, companies are allowed to use bank guarantee facilities, instead of cash, to manage daily margin calls on Nasdaq OMX Commodities (NOMX). Indeed, if collateral requirements are reasonable – and CBG can be accepted – more non-financial counterparties will decide to clear and this would reduce counterparty risks and would benefit the entire financial system. If energy companies would be forced to cover the margining requirements at exchanges with cash only or high minimum levels of cash this would have a significant impact on liquidity risk and could create barriers to entry or undue restrictions on firms' activities.

In the light of the above, EFET is also concerned by the specific proposals to only allow cash covered bank guarantees. If bank guarantees have (i) to be covered by collateral (ii) that is realisable on a same day basis, the use of bank guarantees would not be feasible and rather cash should be used. All bank guarantees of stable banks (as defined under Basel III) should be allowed to be used as collateral as non-financials face different cash liquidity constraints compared to financial firms.

Collateral Requirements (2)

Q46: Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.

We do not agree with ESMA that cash, financial instruments or bank guarantees are only highly liquid where they are denominated in the currency of the jurisdiction where the CCP is established. Market parties should be able to post collateral in any of the strong currencies (e.g. Dollar, Euro, Sterling), but preferably in the currency of the product that is being cleared.

Restrictions on collateral denomination would unnecessarily expose firms to foreign exchange risk which would have to be managed and paid for.

Collateral requirements (3)

Q49: Do you consider that the elements outlined above would rightly outline the framework for determining concentration limits? Should ESMA consider other elements?

Q50: Should a CCP require that a minimum percentage of collateral received from a clearing member is provided in the form of cash? If yes, what factors should ESMA take into account in defining that minimum percentage? What would be the potential costs of that requirement?

The use of cash, bank guarantees or other types of collateral should be seen as interchangeable. The choice of collateral is usually dependant on the cash position of a company, the ease of use of the collateral, and the rules of the exchange/CCP.

Where possible EFET members generally have a preference for the use of letters of credit or bank guarantees for collateral at CCPs. A range of collateral tools are available to firms and as long as these are sufficiently liquid and robust they should be accepted by CCPs. ESMA should not be mandating undue restrictions on how firms manage their collateral with CCPs.

If a minimum level of cash is required for collateral this must be set at a level that does not create barriers to entry to markets or constrain firms' commercial activity. As such, any minimum thresholds should be minimized taking into account other sources of collateral and it would be unlikely that any single level would be appropriate across all CCPs. It is also crucial that clearing members retain title to any cash posted at CCPs that is not directly related to their obligations and that it is subject to robust segregation requirements.

Furthermore, if companies must post a minimum percentage of cash, we would like to note that ESMA should be considerate of the fact that corporations may be forced to borrow additional money to handle the margin requirements at a time when bank lending is under difficult market conditions. Accessing such funds, at a reasonable cost, in current market conditions will be difficult and it will divert cash from other productive activities.

Section 3: Trade repositories (Q69 - Q83)

Reporting Obligation (1)

Q69: What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific items to be reported where particular challenges could be anticipated?

Non-financial firms have not been subject so far to detailed transaction reporting regimes (unlike financial firms), and implementation of the reporting obligations under EMIR and REMIT will involve significant development of the existing systems and possible implementation of new processes, IT architecture and agreements. In order to ensure that non-financial firms have sufficient time to implement the necessary requirements, it is recommended that the go-live date for the reporting requirements is pushed back to later in 2013. This is particularly important as ESMA will provide its advice on the implementing rules under EMIR to the European Commission only in September, after which they will become legally binding. This will not leave a reasonable implementation period for non-financial firms. Further coordination is required in terms of the expected implementation of the REMIT reporting requirements. We urge ESMA to cooperate with ACER both in terms of a timetable for development and implementation of the reporting requirements and the format and content of these arrangements.

We recommend that ESMA and ACER hold joint workshops for this purpose with relevant experts from companies to help further develop the reporting requirements under EMIR and REMIT.

Consistency of format and codification schemes is essential if reporting complexity and costs are to be minimized and a single 'market dataset' (even distributed over multiple TRs) is to be established as a basis for consistent reporting across the various legislative packages (EMIR, REMIT and MiFID). Where possible existing open data exchange standards should be used as they comprise standardized, matching trade data already used within the industry to manage risk on a bilateral basis.

To achieve this, a single open data exchange standard must be mandated (see response to Q70). It is highly recommended that the mandated standard is an existing standard already in use within the industry and/or asset class to exchange and match trade data, standard compliant data from different sources will by definition be compatible and thus suitable for submission to TRs. Furthermore, we wish to emphasise that creation of any new coding schemes should be avoided, use of existing coding schemes (such as EIC codes for legal entity and delivery location identification in energy commodities) which are already utilised within existing data exchange standards is highly recommended in order to avoid a proliferation of equivalent but incompatible or incoherent alternative schemes which would otherwise undermine the aim of a homogeneous data set.

This will require both an agreed format and an agreed use of that format. It will also require an agreed product list across both exchange and OTC traded derivatives.

The draft rules of EMIR states that 'both counterparties report this data however where one counterparty reports on behalf of the other counterparty the data only needs to be reported once'. ESMA must define the rules for how this reporting will work in order to minimise the duplication of effort and reporting across the industry. For example, ESMA could require that the aggressor to a transaction is the primary reporter of the transaction.

Reporting Obligation (2)

Q70: Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?

An agreed list of counterparty codes, together with the standard definition of the code construction, would be preferable to data attributes, such as name and domicile, as such attributes can change over time. With a single counterparty identification code, changes to the counterparty attributes can be managed by amending the details in the central code library. This ensures continuity over time (for example by preserving the link between the new and old name in case of a change in name) and provides a central reference to facilitate the swift propagation of counterparty detail changes across the industry. We therefore recommended that a single codification scheme (possibly per asset class, for instance the EIC scheme in commodities) is mandated as part of the technical requirements to identify counterparties and intermediaries (such as brokers). The counterparty attributes should be removed from the counterparty data requirement.

In general, EFET recommends that an open standard for trade data exchange is mandated (possibly per asset class) and enhanced as necessary with regulatory specific data fields. This approach would both reduce the likelihood of missing important commercial information (such as that related to the Parties to the Contract), since existing standards are tried and tested; and avoid an enormous amount of effort and potential delay in essentially re-inventing an existing facility already in use in the market place.

For the purpose of the Commodities asset class EFET recommends the adoption of the open EFET standard Commodity product Mark-up Language (CpML) which is already widely adopted and already in use for regulatory reporting under ODRF and by October 2012 for Dodd-Frank.

When considering the current list of fields for 'Parties to the Contract' we would therefore recommend reference to such existing standards as the first port of call.

In general it is better to rely on a **single** identification code rather than data attributes, such as name and domicile, since such attributes can change over time. Such changes are better managed by amending the details related to the code identifying the organization which are held in a centrally managed code library.

A single identification code would:

- ensure continuity over time, in case the name of a counterparty or any other detail changes;
- provide a central reference source ensuring that counterparty detail changes are propagated across the industry swiftly.

It is therefore recommended that:

- a single codification scheme (possibly per asset class, for instance the EIC scheme in commodities) is mandated as part of the technical requirements to identify counterparties and intermediaries (such as brokers), and
- the attributes are removed from the counterparty data requirement.

Beneficiaries

Q71: How should beneficiaries be identified for the purpose of reporting to a TR, notably in the case of long chains of beneficiaries?

As we understand this question to relate to investment management, and not for intragroup trades, EFET has no comment on this question.

Coding (1)

Q72: What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?

There is a need for a unique identifier based on a standard definition of a counterparty code. The main challenge is in ensuring universal adoption of one coding scheme or ensuring one-to-one correspondence between codes in separate schemes. It is recommended that only one coding scheme is mandated (at least per asset class) and that the related data is centrally maintained so that propagation of changes across the industry is avoided

As mentioned in Q70, EFET recommends the use of a single identification system and data exchange standard, managed in a centralised way in order to facilitate the identification of counterparties and the pairing of trades by TRs.

Coding (2)

Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?

For commodities, it is recommended that derivative products are identified in a way consistent with confirmations matching, e.g. by specifying the instrument type, underlying commodity, quality, delivery location, and delivery period.

ESMA should take account of the work already undertaken for Dodd-Frank reporting obligations. Taxonomy and UPI are currently established under this regime and energy firms are anticipating to use these. Therefore, EFET recommends that this push for taxonomy and UPIs is reused for EMIR reporting requirements.

Details on the transaction – Trade identification

Q74: How complex would be for counterparties to agree on a trade ID to be communicated to the TR for bilaterally executed transactions? If such a procedure is unfeasible, what would the best solution be to generate the trade ID?

This is not trivial. To have a common trade ID would require a service that counterparties can access to as part of a matching process. When the trade is matched a common code could then be assigned to the trade. Challenges to delivering this would include that trades could only be submitted post confirmation/matching. A separate mechanism could be required to support fax-based confirmations.

It is essential to avoid placing the burden of disseminating common trade IDs on market participants. If the responsibility falls to the counterparties, there will be a need for a complex peer-to-peer communication process which also requires local matching of trade details. The recommended approach is to require that the TRs provide deal pairing and common Trade ID dissemination post confirmation once trade breaks have been addressed and accurate, reconciled data is being submitted to the TR. This approach would provide coverage for all trades submitted electronically to a TR by both parties (and the MTF) without requiring expensive and time consuming changes to execution venue technology or changes to well-established confirmation processes.

Details on the transaction – Pricing and fees

Q75: Would information about fees incorporated into pricing of trades be feasible to extract, in your view?

As we understand this question to relate to broker dealers, EFET has no detailed comment on this question. Broker fees are not comprised in the transaction price / transactional data and are typically paid by only one party to the trade, so that they are typically excluded from the commercial terms matched between the counterparties as part of existing market processes such as electronic confirmation matching.

Risk Mitigation and clearing

Q76: What is your view of the granularity level of the information to be requested under these fields and in particular the format as suggested in the attached table?

In general we highly recommend reuse of existing open standard (see response to Q70) in use within each asset class with relevant enhancements to accommodate regulatory specific fields. See more specific comments below on the reporting fields.

Specific asset classes

Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives? As regards format, comments are welcome on the possible codes listed in the table.

See comments below.

Data on exposure

Q78: Given that daily mark-to-market valuations are required to be calculated by counterparties under [Article 6/8] of EMIR, how complex would it be to report data on exposures and how could this be made possible, particularly in the case of bilateral trades, and in which implementation timeline? Would the same arguments also apply to the reporting of collateral?

We question the usefulness of reporting exposures (for non-cleared trades) at the trade level. Most trade agreements take advantage of certain netting provisions, but the exact application of these provisions depends on what has been agreed in the trading agreement. The trade repository or regulator will therefore be unable to construct the actual credit exposure of one party to another. If there is a requirement to analyse credit exposures between parties in the market, then companies should be required to calculate and report these on a portfolio level, taking into consideration the application of exposure netting.

Unless regulators determine models to be applied when assessing bilateral counterparty risk it will be difficult for them to compare and assess the concentration of exposures and systemic risk given the firms' very individual internal approaches of risk management techniques. Relevant calculations are done beyond the basic database in different systems at different times (most non-financials only calculate their counterparty risk once a week). Combining these separate exposure reporting parts with a transaction reporting system on a daily basis would be very onerous for commodity firms. For these reasons, at least an appropriate phased-in approach is necessary.

Finally, note that requirements to report valuations of exposures / collateral on a daily basis will greatly increase the amount of data flowing to trade repositories, as the number of trades for which a mark-to-market is calculated each day greatly exceeds the number of new trades or trades which have a lifecycle event.

Reporting by third parties

Q79: Do you agree with this proposed approach? What are in your view the main challenges in third party reporting and the best ways to address them?

We do not have fundamental comments on this issue. We note that since a delegation to third parties does not affect the liability of the individual counterparty under the duty to report nor the need to follow all applicable requirements under EMIR, many firms are likely to prefer to submit the data themselves. Furthermore it would become difficult for firms to answer questions from regulators resulting from market monitoring if they do not have control over the data sent to the trade repository.

Field	Comments
ID of Counterparty ID of the other Counterparty	Reporting counterparties will be identified by a unique code identifier. No guidance is given on the naming convention. EFET advises ESMA to use EIC codes in line with existing protocols for EFET confirmation matching and European Transmission System Operator (ETSO) nomination standards. A new counterparty ID

	distinct to EIC codes will generate significant development for firms' existing systems.
ID of broker of Counterparty	Where a counterparty uses a broker to execute the transaction this will be identified by a unique code. No guidance is given as to the naming convention that should be used. EFET advises ESMA to use EIC codes in line with existing protocols for EFET confirmation matching. A new broker ID distinct to EIC codes will generate significant development to existing systems.
ID of clearing member	No details have been provided on the identifier for the naming convention. Modifications to third party exchange traded platforms used by market participants for the trade capture of cleared products will be required to identify and report the ID of the clearing member. This information is currently not held and will require significant systems development.
Trading Capacity	Most EFET firms do not currently classify or tag a transaction as to who the Principle and Agent is – fields which will require further definition with significant new systems development to capture the expected information.
Trade with non-EEA Counterparty	It is difficult to see how reporting of non-EEA counterparties and determining whether they are subject to reporting will work as we will not be a database of reporting eligible counterparties.
Directly linked to commercial activity or treasury financing	It is not possible to identify individual trades in this way as hedging is generally undertaken at a portfolio level.
Clearing threshold	This will only be possible if firms monitor their position against the threshold on a real time (or daily basis) which will generally be dependent on how they implement the definition of hedging. As pointed out in our main response firms need to retain flexibility and as such it would not be appropriate to force companies to a particular solution through the reporting requirements.

Field	Comments
Taxonomy	Reporting counterparties are requested to use taxonomy for describing the classification of the reported contract. No guidance is given on the naming convention which states it has to be defined either by the industry or ESMA.
Product ID	Reporting counterparties are requested that contracts are identified by unequivocal identifiers. No guidance is provided on this – please see our main response for a potential way forward on this issue.
Underlying	Limited guidance is provided and it is not clear how ISO 6166 could be utilised. For baskets and indices ESMA advises to use an

	indication as the identifier. This is open to ambiguity and interpretation and clear guidance from ESMA is required in order to implement this requirement.
Trade ID	Generally, the trading platforms used by firms will generate their own unique trade ID. This will not correlate back to the counterparty. Therefore to come up with a unique identifier for a trade shared between two counterparties will require a fundamental change in current business process and systems.
Venue of Execution	EFET will need to further investigate whether the code is consistent with current standards defined for market definition under the EFET EIC rules.
Type of venue of execution	Limited guidance has been provided on this, however, many of EFET members' existing systems including the data model for trades and markets will need to be enhanced with appropriate mappings of data to comply with EMIR's requirements.
Master Agreement Type	No guidance is provided whether this is a unique identifier for different master agreements. ESMA needs to clarify the reporting requirement for this field.
Confirmation	Most industry participants that comply with EFET electronic confirmation matching adhere to an industry standard 3 day confirmation generation and matching rule. In light of this it is probable that most trades at the time of reporting will be unconfirmed.
Collateralisation	Structural changes to its systems and data models will be necessary to record and report this data field.
Clearing Obligation	As above, this will only be possible where firms monitor the position against the clearing threshold on a real time (or daily basis). It may be easier therefore to simply classify whether a trade has been cleared or not (either voluntarily or due to being subject to the clearing obligation). If the more aggregated approach is taken this will still require developments to systems to capture this information. For OTC give-up trades to the Exchange the trade life cycle will require to be tracked and the clearing status updated.
Log	EMIR requests market participants to build a trail of amendments with relevant supporting information retained in a log to a previously registered trade. No information is provided to the level of detail required in the log. There is also no mention of trade versioning to track each amendment. The extensive and broad trade repository reporting requirements will mean there will be frequent amendments to report significantly increasing the reporting obligation on firms. In light of this a more prudent view should be undertaken of limiting the number of fields for the trade reporting requirements to the commercial terms of the trade only and therefore excluding such fields as confirmation and master

	agreement type.
--	-----------------